

REPORT OF EXAMINATION
PROGRESSIVE NORTHWESTERN INSURANCE COMPANY

Bellevue, Washington

As of December 31, 1997



Participating States:
Washington
Ohio

Progressive Northwestern Insurance Company

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Progressive Northwestern Insurance Company of Bellevue, Washington. This report shows the financial condition and related corporate matters as of December 31, 1997.

PATRICK H. McNAUGHTON
Chief Examiner

Date

Progressive Northwestern Insurance Company

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Progressive Northwestern Insurance Company

Lacey, Washington
January 31, 2000

The Honorable Deborah Senn, Commissioner
Washington Department of Insurance
Insurance Building
P.O. Box 40255
Olympia, WA 98504-0255

Dear Commissioner Senn:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY

of

Bellevue, Washington

hereinafter referred to as "PNWIC" or the "Company," at the location of its parent company's home office, 6300 Wilson Mills Road, Mayfield Village, Ohio 44143-2182. This report is respectfully submitted showing the condition of the Company as of December 31, 1997.

SCOPE OF EXAMINATION

This examination covers the period January 1, 1993 through December 31, 1997 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Insurance Code and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. Additionally, the examiners reviewed and utilized the work papers prepared by examiners from the Ohio Department of Insurance and the Company's independent auditors to the extent possible.

INSTRUCTIONS

The examiners reviewed the Company's filed 1997 Annual Statement as part of the statutory examination. The review focused on determining if the Company's Annual Statement was completed in accordance with the Annual Statement Instructions published by the NAIC. No exceptions were noted while performing this review.

COMMENTS AND RECOMMENDATIONS

The examination developed the following comments and recommendations calculated to prevent non-compliance in the future. No exceptions were noted while performing this review.

HISTORY

Progressive Northwestern Insurance Company was incorporated on September 24, 1982 and commenced business on September 26, 1983, as a property and casualty insurance corporation, domiciled in the state of Washington. PNWIC specializes in underwriting policies for private passenger automobiles, recreational vehicles and small fleets of commercial vehicles.

The Articles of Incorporation were approved by the Insurance Commissioner, State of Washington, and were filed with the Secretary of State, State of Washington, on September 24, 1982.

MANAGEMENT AND CONTROL

Shareholders

All of the outstanding voting stock of PNWIC is owned by The Progressive Corporation (ProgCorp).

Peter B. Lewis, Chairman, President and Chief Executive Officer of ProgCorp, owns approximately 15.4% of the voting stock of ProgCorp and has not filed a disclaimer of control. Therefore, Mr. Lewis is considered to be the Ultimate Controlling Person, a matter which Mr. Lewis neither confirms nor denies. Shareholders with 10% or more of the outstanding voting stock of ProgCorp, as of December 31, 1997, include:

Peter B. Lewis	15.4%
Ruan, Cunniff & Co. Inc.	13.4%
Oppenheimer Group, Inc.	10.6%

Both Ruan, Cunniff & Co. Inc. and Oppenheimer Group, Inc. have filed a Schedule 13G with ProgCorp and the Securities Exchange Commission, and Disclaimers of Control with relevant state insurance departments, indicating that they have acquired securities of ProgCorp in the ordinary course of its business and not with the purpose nor with the effect of changing or influencing the control of ProgCorp.

Board of Directors

In accordance with provisions of the Bylaws, the number of directors shall be at least seven (7). The Bylaws state that a majority of the directors must be citizens and residents of the United States. This provision does not comply with RCW 48.07.050, which states, "Not less than three-fourths of the directors of an incorporated domestic insurer shall be United States or Canadian Citizens." The wording of the Bylaws allowed for the possibility of compliance

Progressive Northwestern Insurance Company

with the Bylaws, by having a majority (four-sevenths equals 57.14%), while at the same time violating RCW 48.07.050, by having less than the three-fourths (75%).

Subsequent to and during the course of the examination, PNWIC revised its Bylaws to require three-fourths of the directors to be United State or Canadian citizens.

The following Directors were serving the Company as of December 31, 1997:

Charles B. Chokel
W. Thomas Forrester, II
William H. Graves
Peter B. Lewis (Chairman)
David M. Schneider
Michael D. Sieger
Tiona M. Thompson

Officers

Management of PNWIC is headed by Peter B. Lewis, Chairman of the Board. Mr. Lewis has served the Progressive Group of Companies since 1955. The Bylaws invest Michael D. Sieger, President and Chief Executive Officer, with the powers and duties to exercise supervision over the business of the Company. Mr. Sieger was appointed President in October 1996, replacing Alan R. Bauer. The following Officers were serving the Company as of December 31, 1997:

Peter B. Lewis	Chairman of the Board
Michael D. Sieger	President, Chief Executive Officer
David M. Schneider	Secretary
Charles B. Chokel	Assistant Vice President, Treasurer
Kathleen M. Cerny	Assistant Secretary
Janet A. Dolohanty	Assistant Vice President, Assistant Treasurer
Jeffrey W. Adler	Assistant Vice President

AFFILIATED COMPANIES

Progressive Northwestern Insurance Company is a member of an insurance holding company group, referred to as 'The Progressive Group.' On March 28, 1997, 'Form B - Insurance Holding Company System Annual Registration Statement' was filed with the Insurance Department of the State of Ohio by Progressive Casualty Insurance Company on behalf of thirty-two (32) participating companies. Subsequent to the examination date an Amendment to 1998 Form B was filed on January 11, 1999. As required by RCW 48.31B.025, Form B was filed with the Washington State Office of Insurance Commissioner.

Progressive Northwestern Insurance Company

The Progressive Corporation

A publicly traded insurance holding company formed in 1965 and the parent company of PNWIC. ProgCorp's eighty-eight (88) subsidiaries and one (1) affiliate company provide personal automobile insurance and other specialty property-casualty insurance and related services throughout the United States and in Canada. Their products protect their policyholders against collision and physical damage to their motor vehicles and liability to others for personal injury or property damage arising out of the use of those vehicles.

On April 2, 1990, PNWIC became a party to the 'Affiliate Agreement - Allocation of Federal Income Taxes.' Under the terms of the agreement, ProgCorp files a consolidated Federal Income Tax return, using the 'Separate-Return Method' to calculate the individual tax liability for its affiliates. The agreement stipulates that each affiliate has ninety (90) days to settle its tax liability resulting from the consolidated return. In addition, settlements are not considered finalized until audited and/or closed by the Internal Revenue Service.

Progressive Casualty Insurance Company

An affiliate property-casualty insurance company, domiciled in the State of Ohio and wholly-owned by ProgCorp. Progressive Casualty Insurance Company (PCIC) became a party to the holding company group on November 17, 1956.

On January 27, 1988, PNWIC entered into the 'Management Agreement' with PCIC. Per the terms of the agreement, PCIC is to provide various management services and office facilities to PNWIC. In return for these services, PNWIC agrees to assume a specified portion of the pooled underwriting expenses of the companies that participate under the 'Inter-Company Reinsurance Treaty' (refer to the Reinsurance section for details). Beginning January 1, 1997 and throughout 1998, PNWIC's specified portion of the pool was 12% of the total underwriting expenses.

On January 1, 1993, PNWIC became a party to an 'Interest Agreement' with PCIC. In order to cut costs and increase efficiencies, a centralized cash management system was developed, whereby, PCIC accounts for the cash activity of each participant. Under the terms of the agreement, interest accrues on a monthly basis, at the prevailing 90-Day Treasury Bill rate, on the last day of each month, computed to the nearest quarter of a percent.

On June 1, 1998, PNWIC became a party to the 'Cash Management Agreement' with PCIC. Under the terms of the agreement, PCIC establishes, accounts, and reports the cash transactions of the participants through a centralized bank or cashier account. PCIC provides monthly statements to each participant, detailing the cash activity for the proceeding month. Interest on the cash balances accrues monthly, per the terms of the 'Interest Agreement.' PCIC settles the inter-company balances quarterly, using the participants' receivable from the cashier account to settle any amounts owed. Participants are required to settle inter-

Progressive Northwestern Insurance Company

company balances no later than 60 days after the end of the quarter. The cashier account system was established in the late 1970's, however, a formal written contract, signed by the participating parties, was not executed until January 1, 1998.

Progressive Premium Budget, Inc.

An affiliate premium financing company, incorporated in the State of Ohio and wholly-owned by ProgCorp.

On July 28, 1983, PNWIC entered into a 'Premium Financing Agreement' with Progressive Premium Budget, Inc. (PPB). Per the terms of the agreement, PPB offers its premium financing facilities to those customers of PNWIC which care to use its services. All amounts due to PNWIC with respect to premiums financed by PPB during any month shall be paid or credited to PNWIC no later than ninety (90) days after the last day of the month in which the premiums were financed.

On January 26, 1983, PNWIC became a party to the 'Interest and Commission Agreement' with PPB. Per the terms of the agreement, PPB agrees to pay interest on any account balance owed to PNWIC which has been due for more than one (1) week. PPB also agrees to pay to or receive credit from PCIC for any balances or overdrafts of PNWIC's balances in the cashier account. Interest will be charged at an effective rate of 1% above the prime rate after consideration of a 20% compensating balance.

Progressive Partners, Inc.

An affiliate investment management company, incorporated in the State of New York and wholly-owned by ProgCorp.

On July 16, 1992, PNWIC became a party to the 'Investment Services Agreement' with Progressive Partners, Inc. (PPI). Per the terms of the agreement, PPI is authorized, directed and agrees to provide investment management services to participating affiliate companies who chose to participate. Such services include, without limitation:

- i. Development of an investment strategy;
- ii. Selection of investments;
- iii. Management of investment transactions.

PPI agrees to comply with the instructions it receives from the officers or directors of the participating company and the selected investments shall be permissible investments under all laws and regulations applicable to such participating company. The expenses of PPI are to be reimbursed by the participating companies each quarter. Each participating company's portion is expressed as a percentage, determined by dividing the Asset Value of the participating company's invested assets by the total of all invested assets. Such amount shall be paid to PPI within thirty (30) days.

Progressive Northwestern Insurance Company

ProgNY Agency, Inc.

An affiliate insurance agency, incorporated in the State of New York and wholly-owned by ProgCorp.

On August 14, 1996, PNWIC became a party to the 'General Agency Agreement' with ProgNY Agency, Inc. (ProgNY). Per the terms of the agreement, ProgNY, as a general agent, is authorized to solicit, provide quotes, receive applications, bind coverage and collect and receive premiums for insurance products in the State of New York. PNWIC issues all policies, endorsements, renewal notices, cancellation notices, certificates, filings and other required documentation of coverage.

United Financial Insurance Agency, Inc. and United Financial Insurance Agency of Washington, Inc.

Affiliate insurance agencies, incorporated in the States of Ohio and Washington, respectively. United Financial Insurance Agency of Washington, Inc. (UFIWA) is a wholly-owned subsidiary of United Financial Insurance Agency, Inc. (UFIA). UFIA is a wholly-owned subsidiary of The Paradyne Corporation, which is wholly-owned by ProgCorp.

On May 15, 1996, PNWIC became a party to the 'Producer's Agreement' with UFIWA and UFIA. Per the terms of the agreement, UFIWA and UFIA, as general agents, are authorized to solicit, provide quotes, receive applications, bind coverage and collect and receive premiums for insurance products in all states where appropriate licenses and appointments have been obtained. PNWIC issues all policies, endorsements, renewal notices, cancellation notices, certificates, filings and other required documentation of coverage.

Progressive Adjusting Company, Inc.

An affiliate company, incorporated in the State of Ohio, wholly-owned by ProgCorp.

On February 1, 1992, PNWIC became a party to the 'Loss Adjustment Service Agreement' with Progressive Adjusting Company, Inc. (PAC). Per the terms of the agreement, PAC processes, investigates, pays, settles and/or arranges for the defense of, all claims. PAC has no authority to deny any claim, except in accordance with the Company's guidelines provided to PAC. The Company pays PAC within thirty (30) days after receipt for open features, claims handling fees and claims expenses.

The Progressive Agency, Inc.

An affiliate insurance agency, incorporated in the Commonwealth of Virginia and wholly-owned by ProgCorp.

Progressive Northwestern Insurance Company

On October 29, 1996, PNWIC became a party to the 'General Agency Agreement' with The Progressive Agency, Inc. (PAI). Per the terms of the agreement, PAI, as a general agent, is authorized to solicit, provide quotes, receive applications, bind coverage and collect and receive premiums for insurance products in the State of Connecticut. PNWIC issues all policies, endorsements, renewal notices, cancellation notices, certificates, filings and other required documentation of coverage.

CAPITAL AND SURPLUS

On December 29, 1993, the Board of Directors approved the issue of 2,857 shares of authorized and unissued shares of Common Capital Stock, Par Value \$175.00, to the Company's sole shareholder, ProgCorp, and the transfer of \$499,975 from Gross Paid In and Contributed Surplus to Common Capital Stock.

Progressive Northwestern Insurance Company has 40,000 authorized shares of \$175.00 par value, voting, common stock. As of December 31, 1997, 17,143 shares of common stock were outstanding, with a value of \$3,000,025. Additional Gross Paid In and Contributed Surplus was \$72,299,975. The total paid in capital stock and additional surplus equaled \$76,000,000, exceeding the minimum requirements set forth in RCW 48.05.340. The outstanding shares are wholly-owned by The Progressive Corporation.

During and subsequent to the examination period, the Board of Directors approved the following dividends to its sole shareholder, ProgCorp. The dividends are deemed to be ordinary dividends.

December 15, 1993	\$ 4,710,000
December 20, 1995	3,900,000
December 12, 1996	20,000,000
December 31, 1998	17,000,000

During the examination period, the Company received the following contributions to surplus from its parent company, ProgCorp:

1994	\$12,000,000
1997	36,000,000

CORPORATE RECORDS

The examiners reviewed the corporate records of PNWIC for the period under examination. All Board meetings were conducted with a quorum present. The Board members ratified all changes to the Articles of Incorporation and Bylaws.

INTERNAL SECURITY

Conflict of Interest

Progressive Northwestern Insurance Company has a policy statement and questionnaire for the disclosure of conflicts of interest and requires all directors and officers to sign the statement annually. The signed statements are reviewed annually for conflicting situations. The Board of Directors reviews any statement that may contain conflicting situations and takes appropriate action there upon.

Fidelity Bond and Other Insurance

Progressive Northwestern Insurance Company is a named insured on an extensive portfolio of insurance providing coverage against all catastrophic and other losses for ProgCorp and its subsidiaries. The NAIC suggested minimum amounts of fidelity insurance were calculated for ProgCorp and its subsidiaries at a minimum of \$3,500,000 - \$4,000,000. As of December 31, 1997, ProgCorp carries fidelity coverage of \$10,000,000.

TERRITORY AND PLAN OF OPERATIONS

Progressive Northwestern Insurance Company is authorized to do business in thirty-nine (39) states and the District of Columbia. The Progressive Group of Companies is in the process of changing and enhancing its core business from a provider of niche products through independent agents. The Group's goal is to become a low cost provider of a full line of auto insurance and related services distributed through many different channels.

The Progressive Group of Companies' core products are marketed by fifty-four (54) business units in or near the markets they serve. Each business unit is responsible for its own marketing, sales, processing and claims. In addition, each business unit and the Corporate Legal Department keep abreast of regulatory issues impacting each unit's business operations as well as competitive changes which may effect each unit's particular markets. Every month, each business unit is required to communicate these types of changes to senior management.

GROWTH OF COMPANY

The following schedules reflect the growth of the Company by year beginning in 1993. The amounts shown were compiled from the Company's filed Annual Statements:

Progressive Northwestern Insurance Company

Schedule 1

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus & Other Funds</u>
1997	624,072,874	443,041,980	181,030,894
1996	414,478,293	295,416,087	119,062,206
1995	363,297,945	252,141,546	111,156,399
1994	250,954,381	158,776,775	92,177,606
1993	196,133,466	138,507,491	57,625,975

Schedule 2

<u>Year</u>	<u>Premiums Earned</u>	<u>Underwriting Deductions</u>	<u>Net Underwriting Gain or Loss</u>	<u>Investment and Other Income</u>	<u>Pre-Tax Income</u>
1997	449,929,303	434,418,328	15,510,975	37,141,680	52,652,655
1996	292,879,284	276,262,434	16,616,850	28,426,912	45,043,762
1995	254,853,275	247,466,580	7,386,695	31,398,027	38,784,722
1994	147,218,296	136,011,599	11,206,697	19,378,535	30,585,232
1993	110,003,059	103,647,928	6,355,131	15,313,450	21,668,581

REINSURANCE

On January 1, 1988, PNWIC became a party to the 'Inter-Company Reinsurance Treaty' with Progressive Casualty Insurance Company and ten (10) affiliate companies. The purpose of the agreement is to pool certain property/casualty business, net of external reinsurance, and to pro-rate the combined net premiums, losses, loss adjustments and underwriting expenses to the pool participants in proportion to established ratios. Effective January 1, 1997 and through 1998, the pool participants and established ratios were as follows:

<u>Pool Participants</u>	<u>Established Ratio</u>
Progressive American Insurance Company	3.00%
Progressive Bayside Insurance Company	1.00%
Progressive Casualty Insurance Company	46.00%
Progressive Gulf Insurance Company	2.00%
Progressive Mountain Insurance Company	1.00%
Progressive Northern Insurance Company	12.00%
Progressive Northwestern Insurance Company	12.00%
Progressive Preferred Insurance Company	6.00%
Progressive Southeastern Insurance Company	1.00%
Progressive Specialty Insurance Company	13.00%
Classic Insurance Company	3.00%

Ceding Provisions

The Pool Participants obligate themselves to cede to PCIC, and PCIC obligates itself to reinsure, 100% of the Net Retention Liability and Underwriting Expenses under all policies issued during and previous to the term of the agreement.

Retrocession Provisions

The Pool Participants agree to assume pro-rata participating shares of the pool, which shall include Net Retention Liability, Underwriting Expenses and Earned Premium Net of Reinsurance.

Insolvency Clause

Each party to the Inter-Company Reinsurance Treaty agrees that in the event of the insolvency of any party, the agreement is so construed that the reinsurance due hereunder shall be payable directly to the insolvent party or its liquidator, receiver, or statutory successor by the reinsurer on the basis of the liability of the insolvent party under the contract or contracts reinsured without diminution because of the insolvency. It is further agreed that the liquidator, the receiver or the statutory successor of the insolvent party shall give written notice to the reinsurer of the pendency of a claim against the insolvent party on the policy reinsured within a reasonable time after such claim is filed in the insolvency proceedings; that during the pendency of such claim the reinsurer may investigate such claim and interpose at its own expense in the proceeding where such claim is to be adjudicated any defense or defenses which it may deem available to the insolvent party or its liquidator, receiver or statutory successor; subject to court approval, against the insolvent party as part of the expense of liquidation to the extent of the proportionate benefit which may accrue to the insolvent party solely as a result of the defense undertaken by the reinsurer.

It is further agreed and understood that as to all reinsurance made, ceded, renewed or otherwise becoming affective, the reinsurance shall be payable by the reinsurer directly to the insolvent party or to its liquidator, receiver or statutory successor.

Progressive Northwestern Insurance Company

External Reinsurance Contracts

The principle contracted external reinsurers are American Bankers Professional and Fidelity Insurance Company, Ltd., Viking Insurance Company, Ltd., AXA Reinsurance Company, Hartford Fire Insurance Company, PMA Reinsurance Corporation, Gerling Global Reinsurance Corporation (U.S. Branch), Tokio Re Corporation, Hannover Ruckversicherungs-AG, Winterthur Reinsurance Corporation of America, Advanta Insurance Company, Response Insurance Company, Toyota Motor Insurance Company and FirstExcess & Reinsurance Corporation. Each of these companies are authorized reinsurers in the State of Washington. The terms of the reinsurance agreements in effect for 1997 are:

	<u>Coverage Limits</u>
Quota Share/Proportional on	
D&O, E&O, Financial Institution	50% of First \$1,000,000
Bond, Excess Employee Dishonesty	95% of Next \$4,000,000
Bond, Combination Safe Depository,	
Signature Guarantee Surety Bond	
Employment Practices Liability	87.5% of First \$1,000,000
	100% of Next \$4,000,000
90% Quota Share on	
GAP Physical Damage	Maximum Gross Exposure \$25,000
	Net Exposure \$2,500
Physical Damage for Automobile	Maximum Gross Exposure \$10,000,000
Dealer Inventories	Net Exposure \$500,000
50% Quota Share on	
Private Passenger Auto Business	Maximum Gross Exposure \$500,000
sold through Advanta Ins. Co.	Net Exposure \$250,000
30% Quota Share on	
Private Passenger Auto Business	Maximum Gross Exposure \$500,000
sold through Response Ins. Co.	Net Exposure \$350,000

ACCOUNTING RECORDS AND PROCEDURES

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) modified accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for Annual Statement reporting. The Company is audited annually by the Certified Public Accountants, PricewaterhouseCoopers, LLP, and that firm issued its

unqualified opinion for the year ending December 31, 1997.

EDP SYSTEMS AND OPERATIONS

The Management of PNWIC is sufficiently knowledgeable of EDP issues and provides direction and oversight through its Steering Committee. Systems Development, Acquisition and Maintenance Controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. The Internal Controls in place provide for the proper separation of duties.

Operations and Application Controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed and the controls exercised to maintain data security. Adequate procedures and controls are in place for network operations, PC's and Year 2000 issues. The Company has completed its system testing and is considered to be Year 2000 compliant.

SUBSEQUENT EVENTS

No material events subsequent to the examination date were noted which would have a significant effect in the financial condition of Progressive Northwestern Insurance Company.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The previous examination report, dated December 31, 1991, included the following Comments and Recommendations, calculated to prevent non-compliance in the future.

1. General Interrogatories

The Company's 1991 Annual Statement, General Interrogatories, Statement No. 4, did not reflect the change of Par Value from \$160 to \$175 per share. It is recommended that the General Interrogatories, Statement No. 4, be answered correctly.

A review of the 1997 Annual Statement, General Interrogatories, Statement No. 4, noted that the Company has complied with this recommendation.

Progressive Northwestern Insurance Company

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Progressive Northwestern Insurance Company as of December 31, 1997:

Statement of Assets, Liabilities, Surplus and Other Funds
Underwriting and Investment Exhibit
Analysis of Examination Changes in Financial Statements
Comparative Statement of Assets, Liabilities, Surplus and Other Funds
Comparative Underwriting and Investment Exhibit
Five Year Reconciliation of Surplus and Other Funds

No examination adjustments or reclassifications were required for the examination financial statements.

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY
Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 1997

	<u>Balance Per Company</u>	<u>Adj. No.</u>	<u>Examination Adjustments</u>	<u>Ref.</u>	<u>Balance Per Examination</u>
<u>ASSETS</u>					
Bonds	\$ 445,207,206			2A	\$ 445,207,206
Cash	1,047,842			2B	1,047,842
Subtotals, cash and invested assets	446,255,048		-		446,255,048
Premiums and agents' balances in course of collection	11,150,023				11,150,023
Premiums and agents' balances and installments booked but deferred and not yet due	147,294,711				147,294,711
Reinsurance recoverables on loss and loss adjustment expense payment	146,107				146,107
Interest, dividends and real estate income due and accrued	3,554,323				3,554,323
Receivable from parent, subsidiaries and affiliates	15,672,662			4	15,672,662
Total assets	\$ 624,072,874		\$ -		\$ 624,072,874
<u>LIABILITIES</u>					
Losses	\$ 163,059,566			7	\$ 163,059,566
Loss adjustment expenses	34,074,973				34,074,973
Contingent commissions and other similar charges	1,263,047				1,263,047
Other expenses (excluding taxes, licenses and fees)	10,416,238				10,416,238
Taxes, licenses and fees (excluding federal and foreign income taxes)	3,009,150				3,009,150
Unearned premiums	207,617,457				207,617,457
Excess of statutory reserves over statement reserves	1,504,000				1,504,000
Drafts outstanding	19,537,458				19,537,458
Aggregate write-ins for liabilities	2,560,091				2,560,091
Total liabilities	443,041,980		-		443,041,980
<u>SURPLUS AND OTHER FUNDS</u>					
Common capital stock	3,000,025				3,000,025
Gross paid in and contributed surplus	72,299,975				72,299,975
Unassigned funds (surplus)	105,730,894				105,730,894
Surplus as regards policyholders	181,030,894		-		181,030,894
Total liabilities, surplus and other funds	\$ 624,072,874		\$ -		\$ 624,072,874

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY

Underwriting and Investment Exhibit

As of December 31, 1997

STATEMENT OF INCOME

	<u>Balance Per Company</u>	<u>Adj. No.</u>	<u>Examination Adjustments</u>	<u>Ref.</u>	<u>Balance Per Examination</u>
<u>UNDERWRITING INCOME</u>					
Premiums earned	\$ 449,929,303				\$ 449,929,303
DEDUCTIONS					
Losses incurred	258,611,493				258,611,493
Loss expenses incurred	60,842,726				60,842,726
Other underwriting expenses incurred	114,964,109				114,964,109
	<hr/>		<hr/>		<hr/>
Total underwriting deductions	434,418,328		-		434,418,328
	<hr/>		<hr/>		<hr/>
Net underwriting gain or (loss)	15,510,975		-		15,510,975
<u>INVESTMENT INCOME</u>					
Net investment income earned	19,938,734			8	19,938,734
Net realized capital gains or (losses)	1,257,907				1,257,907
	<hr/>		<hr/>		<hr/>
Net investment gain or (Loss)	21,196,641		-		21,196,641
<u>OTHER INCOME</u>					
Net gain or (loss) from agents' or premium balances charged off	(4,906,511)				(4,906,511)
Finance and service charges not included in premiums	17,972,154				17,972,154
Aggregate write-ins for miscellaneous income	2,879,396			9	2,879,396
	<hr/>		<hr/>		<hr/>
Total other income	15,945,039		-		15,945,039
	<hr/>		<hr/>		<hr/>
Net income before dividends to policyholders and before federal and foreign income taxes	52,652,655		-		52,652,655
	<hr/>		<hr/>		<hr/>
Dividends to policyholders	-				-
	<hr/>		<hr/>		<hr/>
Net income, after dividends to policyholders but before federal and foreign income taxes	52,652,655		-		52,652,655
	<hr/>		<hr/>		<hr/>
Federal and foreign income taxes incurred	24,163,230				24,163,230
	<hr/>		<hr/>		<hr/>
Net income	<u>\$ 28,489,425</u>		<u>\$ -</u>		<u>\$ 28,489,425</u>
<u>CAPITAL AND SURPLUS ACCOUNT</u>					
Surplus as regards policyholders, December 31, prior year	\$ 119,062,206				\$ 119,062,206
<u>GAINS AND (LOSSES) IN SURPLUS</u>					
Net income	28,489,425				28,489,425
Net unrealized capital gains or (losses)	-				-
Change in non-admitted assets	(1,975,737)				(1,975,737)
Change in excess of statutory reserves over statement reserves	(545,000)				(545,000)
Surplus Adjustments: Paid In	36,000,000				36,000,000
	<hr/>		<hr/>		<hr/>
Change in surplus as regards policyholders for the year	61,968,688		-		61,968,688
	<hr/>		<hr/>		<hr/>
Surplus as regards policyholders, December 31, current year	<u>\$ 181,030,894</u>		<u>\$ -</u>		<u>\$ 181,030,894</u>

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY
Analysis of Examination Changes in Financial Statements
As of December 31, 1997

	Adj. No.	INCREASE/ (DECREASE)	
Surplus as regards policyholders, per company			\$ 181,030,894
<u>ASSETS</u>			
Common stock	(1)	\$ -	
See Instructions No. 2			
Uncollected premiums	(2)	-	
See Instructions No. 4			
Amounts receivable relating to uninsured accident and health plans	(3)	-	
See Recommendations No. 2			
Federal income tax recoverable and other refunds	(4)	-	
To adjust to actual refund due			
Electronic data processing equipment	(5)	-	
See Instructions No. 5			
Aggregate write-ins for other than invested assets:			
Westsound Community Health Network	(6)	-	
See Instructions No. 6			
Aggregate write-ins for other than invested assets:			
Miscellaneous Receivables	(7)	-	
See Instructions No. 7			
<u>LIABILITIES</u>			
Liability for amounts held under uninsured accident and health plans	(3)	-	
See Recommendations No. 2			
Other expenses due or accrued	(8)	-	
See Instructions No. 8 and 9			
Aggregate write-ins for other liabilities	(10)	-	
See Instructions No. 11b			
<u>SURPLUS AND OTHER FUNDS</u>			
Aggregate write-ins for reserves and other funds	(9)	-	
To adjust reported value of unrealized gain on stocks			
Unassigned funds	(9)	-	
To adjust reported value of unrealized gain on stocks			
Net Increase/(Decrease) to Surplus			-
Surplus as regards policyholders, per examination			\$ 181,030,894

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY
Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,

	<u>1997</u>	<u>1996</u>
<u>ASSETS</u>		
Bonds	\$ 445,207,206	\$ 303,631,433
Cash	1,047,842	29,647
Subtotals, cash and invested assets	446,255,048	303,661,080
Premiums and agents' balances in course of collection	11,150,023	8,031,867
Premiums and agents' balances and installments booked but deferred and not yet due	147,294,711	91,621,362
Reinsurance recoverables on loss and loss adjustment expense payments	146,107	3,196
Interest, dividends and real estate income due and accrued	3,554,323	3,745,599
Receivable from parent, subsidiaries and affiliates	15,672,662	7,415,189
Total assets	\$ 624,072,874	\$ 414,478,293
<u>LIABILITIES</u>		
Losses	\$ 163,059,566	\$ 118,038,965
Loss adjustment expenses	34,074,973	22,145,215
Contingent commissions and other similar charges	1,263,047	731,662
Other expenses (excluding taxes, licenses and fees)	10,416,238	7,630,769
Taxes, licenses and fees (excluding federal and foreign income taxes)	3,009,150	2,857,884
Unearned premiums	207,617,457	124,288,166
Excess of statutory reserves over statement reserves	1,504,000	959,000
Drafts outstanding	19,537,458	16,137,115
Aggregate write-ins for liabilities	2,560,091	2,627,311
Total liabilities	443,041,980	295,416,087
<u>SURPLUS AND OTHER FUNDS</u>		
Common capital stock	3,000,025	3,000,025
Gross paid in and contributed surplus	72,299,975	36,299,975
Unassigned funds (surplus)	105,730,894	79,762,206
Surplus as regards policyholders	181,030,894	119,062,206
Total liabilities, surplus and other funds	\$ 624,072,874	\$ 414,478,293

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY
Comparative Underwriting and Investment Exhibit
For the Years Ended December 31,

STATEMENT OF INCOME

	<u>1997</u>	<u>1996</u>
<u>UNDERWRITING INCOME</u>		
Premiums earned	\$ 449,929,303	\$ 292,879,284
DEDUCTIONS		
Losses incurred	258,611,493	174,495,091
Loss expenses incurred	60,842,726	32,049,789
Other underwriting expenses incurred	114,964,109	69,717,554
Total underwriting deductions	<u>434,418,328</u>	<u>276,262,434</u>
Net underwriting gain or (loss)	<u>15,510,975</u>	<u>16,616,850</u>
<u>INVESTMENT INCOME</u>		
Net investment income earned	19,938,734	16,198,107
Net realized capital gains or (losses)	1,257,907	(495,196)
Net investment gain or (Loss)	<u>21,196,641</u>	<u>15,702,911</u>
<u>OTHER INCOME</u>		
Net gain or (loss) from agents' or premium balances charged off	(4,906,511)	(4,001,642)
Finance and service charges not included in premiums	17,972,154	13,096,438
Aggregate write-ins for miscellaneous income	2,879,396	3,629,205
Total other income	<u>15,945,039</u>	<u>12,724,001</u>
Net income before dividends to policyholders and before federal and foreign income taxes	<u>52,652,655</u>	<u>45,043,762</u>
Dividends to policyholders	-	-
Net income, after dividends to policyholders but before federal and foreign income taxes	<u>52,652,655</u>	<u>45,043,762</u>
Federal and foreign income taxes incurred	24,163,230	16,697,051
Net income	<u>\$ 28,489,425</u>	<u>\$ 28,346,711</u>

PROGRESSIVE NORTHWESTERN INSURANCE COMPANY
Five Year Reconciliation of Surplus and Other Funds
As of December 31,

	<u>1997</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>	<u>1993</u>
<u>CAPITAL AND SURPLUS ACCOUNT</u>					
Surplus as regards policyholders, December 31, prior year	\$ 119,062,206	\$ 111,156,399	\$ 92,177,606	\$ 57,625,975	\$ 47,121,213
<u>GAINS AND (LOSSES) IN SURPLUS</u>					
Net income	28,489,425	28,346,711	24,643,609	20,786,568	14,915,736
Net unrealized capital gains or (losses)	-		(499,257)	(767,171)	832,227
Change in non-admitted assets	(1,975,737)	79,365	(857,187)	(587,054)	(260,337)
Change in provision for reinsurance		46,731	(46,372)	(359)	
Change in excess of statutory reserves over statement reserves	(545,000)	(567,000)	(362,000)	443,100	(272,864)
Capital changes:					
a. Paid in					375,025
Surplus adjustments:					
a. Paid in	36,000,000			12,000,000	(375,025)
Dividends to stockholders (cash)		(20,000,000)	(3,900,000)		(4,710,000)
Aggregate write-ins for gains and losses in surplus				2,676,547	
Change in surplus as regards policyholders for the year	<u>61,968,688</u>	<u>7,905,807</u>	<u>18,978,793</u>	<u>34,551,631</u>	<u>10,504,762</u>
Surplus as regards policyholders, December 31, current year	<u>\$ 181,030,894</u>	<u>\$ 119,062,206</u>	<u>\$ 111,156,399</u>	<u>\$ 92,177,606</u>	<u>\$ 57,625,975</u>

NOTES TO THE FINANCIAL STATEMENTS

1. Basis of Presentation

The financial statements included herein have been prepared in accordance with accounting practices prescribed or permitted by the Washington State Office of Insurance Commissioner. Prescribed statutory accounting practices include a variety of publications of the NAIC, as well as state laws, regulations, and general administrative rules.

2. Investments

Investments are valued based on the NAIC's Valuation of Securities Manual and Chapter 48.12 of the Revised Code of Washington.

A. Bonds

Bonds are generally reported at amortized cost using the scientific method, which closely approximates the effective interest method. The statement value, unrealized gains and losses, estimated market values and acquisition cost of bonds held for investment as of December 31, 1997 were as follows:

	Statement <u>Value</u>	Unrealized Gains/ <u>(Losses)</u>	Market <u>Value</u>	Actual <u>Cost</u>
U.S. Government	\$273,142,149	\$278,201	\$273,420,350	\$273,149,250
States, Terr. & Poss.	45,243,572	845,528	46,089,100	45,659,012
Political Subdivisions	12,168,084	(298,687)	11,869,397	12,206,176
Special Revenue	72,774,398	1,482,402	74,256,800	72,144,973
Industrial & Misc.	<u>41,879,003</u>	<u>0</u>	<u>41,879,003</u>	<u>42,013,837</u>
Total	<u>\$445,207,206</u>	<u>\$2,307,444</u>	<u>\$447,514,650</u>	<u>\$445,173,248</u>

The maturity distribution of all bonds owned as of December 31, 1997 was as follows:

	Statement <u>Value</u>	Percent of <u>Portfolio</u>
Due in one year or less	\$ 19,582,445	4.4%
Due over one year through five years	308,365,495	69.3%
Due over five years through ten years	70,134,704	15.7%
Due over ten years through twenty years	16,124,562	3.6%
Over twenty years	<u>31,000,000</u>	<u>7.0%</u>
Total	<u>\$445,207,206</u>	<u>100.0%</u>

Progressive Northwestern Insurance Company

The Securities Valuation Office classification distribution as of December 31, 1997 was as follows:

	Statement Value	Percent of Portfolio
Class 1	\$445,207,206	100.0%
Total	<u>\$445,207,206</u>	<u>100.0%</u>

B. Cash And Short-Term Investments

Short-term investments include securities acquired within one (1) year of maturity and are reported at amortized cost, which approximates market value. The statement value of Cash and Short-Term Investments, as of December 31, 1997 were as follows:

Cash	\$ 25,000
Short-Term Investments	<u>1,022,842</u>
Total	<u>\$1,047,842</u>

3. Federal Income Tax Allocation

The Company's Federal Income Tax Return is consolidated with ProgCorp and all of its wholly-owned subsidiaries. The method of allocation between the companies is subject to written agreement and is approved by Board of Directors of ProgCorp and PNWIC. Allocation is based upon separate tax return calculations. Intercompany tax balances are settled within ninety days.

4. Information Concerning Parent, Subsidiaries and Affiliates

All outstanding common stock shares of the Company are owned by ProgCorp. The Company carries a payable to or receivable from parent and affiliates. This balance is due to the timing of security purchases and cash collections and disbursements under the group's centralized cash management system and other intercompany agreements. The intercompany balances are settled quarterly.

5. Non-Admitted Assets

Certain assets designated as "non-admitted," which consist of miscellaneous receivables, have been excluded from the balance sheet. The non-admitted assets are reflected as direct adjustments from net worth. The total non-admitted assets as of December 31, 1997 consisted of the following assets:

Progressive Northwestern Insurance Company

Premiums and agents' balances	\$4,777,169
Prepaid expenses	100
Miscellaneous	<u>197,519</u>
Total	<u><u>\$4,974,688</u></u>

6. Reinsurance

Accruals and reserves for property and casualty policies, premium revenues and losses incurred are reported net of reinsurance in the financial statements. Net Written Premiums for the year ending December 31, 1997 is as follows:

	<u>Direct Business</u>	<u>Reinsurance Assumed</u>	<u>Reinsurance Ceded</u>	<u>Net Premiums Written</u>
Total	\$566,473,397	\$533,258,536	\$566,473,397	\$533,258,534
To/From Affiliates		\$533,258,536	\$565,735,414	
To/From All Others		0	737,985	

7. Loss Reserves

Property and casualty policies had the following reserves for the year ending December 31, 1997:

Case Reserves	\$130,074,881
IBNR	<u>32,984,679</u>
Total Loss Reserve	<u><u>\$163,059,560</u></u>

8. Net Investment Income

The following is a summary of net investment income earned for the year ending December 31, 1997:

Bonds	\$18,729,039
Cash on hand and on deposit	582
Short-term investments	<u>1,543,349</u>
Gross investment income	20,272,970
Investment expenses	<u>(334,236)</u>
Net Investment Income	<u><u>\$19,983,734</u></u>

9. Aggregate Write-Ins For Miscellaneous Income

Aggregate Write-Ins For Miscellaneous Income as of December 31, 1997 consisted of the following item:

Progressive Northwestern Insurance Company

Miscellaneous income	\$ 103,128
Service business revenue	876,411
Interest income on intercompany balances	<u>1,899,857</u>
Total	<u>\$2,879,396</u>

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Progressive Northwestern Insurance Company during the course of this examination.

In addition, acknowledgment is made of the participation in the work and preparation to this report by John R. Jacobson, AFE, Examiner-in-Charge; Kevin Thomas; all from the Washington Office of Insurance Commissioner; William T. Geiszler, CFE, CIE, Examiner-in-Charge; Mary D. Miller, FCAS, MAAA; Larry G. Rice, CPA, AFE; Douglas E. Standley, CFE, CIE; all from the Ohio Department of Insurance.

Progressive Northwestern Insurance Company

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
COUNTY OF THURSTON }

John R. Jacobson, AFE, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Progressive Northwestern Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

John R. Jacobson, AFE
Examiner-in-charge
State of Washington

Subscribed and sworn to before me this ____ day of _____, 2000.

Notary Public in and for the
State of Washington.